NATIONAL FORECAST DESCRIPTION

The Forecast Period is the Second Quarter of 2003 through the Fourth Quarter of 2006

Many economists will no doubt be tempted to boost their forecasts based on the recent stream of positive economic news. The current business inventory-to-sales ratio hit an all-time low of 1.36 thanks to a huge drop in inventories this August. So far, any pullbacks in the important consumer sector have been minor. September total retail sales were down a mere 0.2%, but non-auto sales actually improved 0.3%. Housing is also strong. In September annualized U.S. housing starts nearly hit 1.9 million units. Manufacturing production grew a healthy 0.7% in September because of a surge in its vehicle and parts component. Despite all of this activity, inflation remained tame. Part of the reason was the strong nonfarm business productivity growth. The biggest news was payrolls expanded by 57,000 in September, ending a declining streak that began in February 2003.

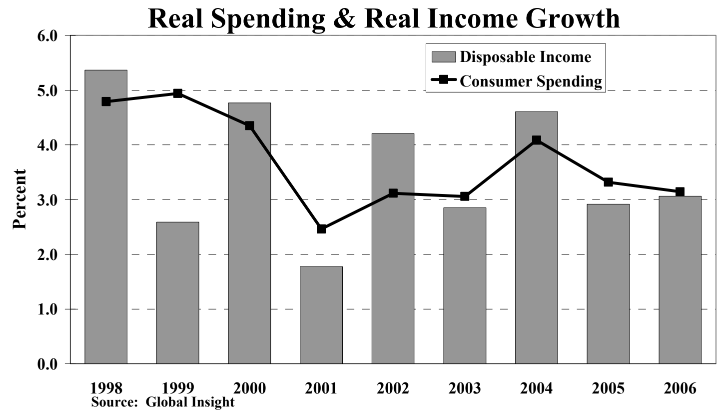
The recent economic news was encouraging, but economists should seriously consider whether they serve as sufficient grounds for raising previous forecasts. The September employment gain was an important milestone. However, it was just one month's data. While it could mark the beginning of a turnaround, a few more months of employment gains are what it will take to raise the comfort level, that the job-loss recovery has given way to an expanding workforce. It should also be remembered September's job gain was relatively small. This is why the unemployment rate did not budge from 6.1%. The September job gain was welcomed, but monthly gains need to be about twice as big to drive down the unemployment rate.

It also needs to be pointed out that what has happened recently is very close to what many economists had previously forecasted. Early last year the consensus was that after a disappointing start, the economic recovery would build steam during the second half of the year. However, before economists start high-fiving each other, they might consider the following. To paraphrase Mark Twain, "The news of the economic recovery has been greatly exaggerated."

Economists have been predicting the economic turnaround for some time, only to be disappointed. They would then push back the timing of the recovery, and be disappointed again. Indeed, the so-called jobless recovery could just as well have been called the postponed recovery. It should also be noted the increase in jobs nearly missed its deadline. Economist watched with despair during the first two months of the second half of this year when employment continued shrinking despite predictions the economy would be growing. The entire profession breathed a collective sigh of relief when the September employment numbers showed a gain.

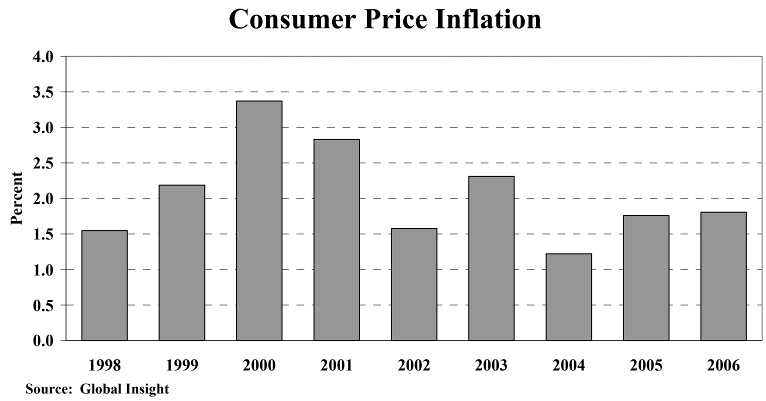
There appears to be ample evidence the economy turned a corner this fall. However, there is less evidence that forecasts should be raised significantly. In the current economic forecast real GDP is expected to rise 2.6% this year, 4.1% next year, 3.7% in 2005, and 3.6% in 2006. After declining slightly in 2003, U.S. nonfarm employment should increase 1.6% in 2004, 2.0% in 2005, and 1.7% in 2006. Consumer price inflation is anticipated to be 2.3% in 2003, 1.2% in 2004, and 1.8% in both 2005 and 2006.

SELECTED NATIONAL ECONOMIC INDICATORS

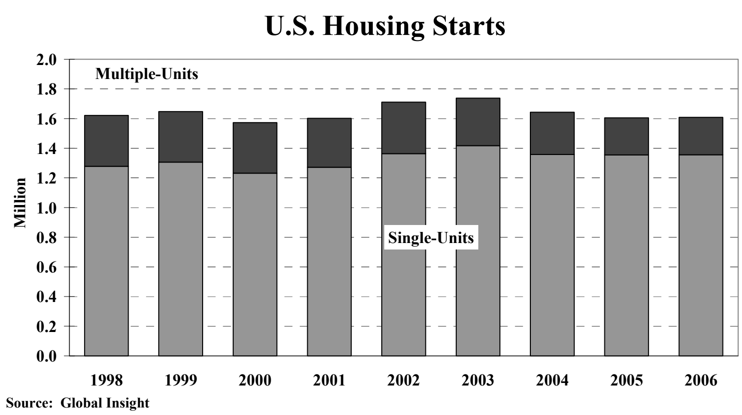


Consumer Spending: One of the greatest uncertainties facing the U.S. economy is whether consumers will continue their spending spree. This is important because the consumers have kept the economy afloat over the last few years, and a sudden retreat would have negative consequences. Real consumer spending grew faster than real GDP in 11 of the 12 quarters since the second quarter of 2000. What makes this especially interesting is consumer spending continued expanding during the recession, which reduced the recession's severity. In the past, the majority of recessions resulted from shrinking consumer spending, especially for large-ticket items. This is another way spending broke with tradition. Spending on durable goods thrived during the most recent ebb in the business cycle. For example, real spending on motor vehicles and parts grew in each quarter of 2001, despite that year's recession. In the last quarter (after 9/11/2001) alone, it expanded at a nearly 66% annual rate. This growth reflected attractive finance options and other incentives. These have continued in various forms since then. The value of incentives reached new highs, averaging $5,500 per vehicle this summer. Other durable goods, such as appliances, benefited from low interest rates and the red-hot housing market. The impact of low interest rates on financed purchases is obvious, but the housing market's impact is subtle. Durable goods spending improves when the housing market is hot because new owners soon make changes to personalize their new abodes. There are a few reasons why spending on durable goods cannot continue at its breakneck pace. One has to do with demographics. For example, in the long run the housing stock's expansion is limited by new household formations. Similarly, the automobile stock should keep pace with the growth in licensed drivers. If light vehicle sales continue near current levels, the stock of vehicles would grow 1.6% over the next five years, while the driving-age population would grow just 1.1%. As was mentioned above, these are long-term threats. A much bigger concern is spending will be dampened by the large amount of debt consumers have taken on over the last few years. However, this does not seem to be a problem as of yet. This is because spending is not affected by the size of debt, but instead the ability to service it. Thanks to low interest rates, debt service appears manageable. In fact, the percent of debt service to disposable income is expected to remain under the 14% peak in 2000. Another fear is spending will be a victim of the fallout from the equity market plunge. In 2002, U.S. household net worth declined 8.7%, due solely to the nearly 23% drop in the value of equities. Fortunately, this drop was buffered by rising home values. After a tumultuous 2002, households' balance sheets are expected to stabilize and other indicators of consumers' financial health should improve. For instance, the number of personal bankruptcies should decline over the forecast period. In light of these factors, consumer spending should slow, but not stall, over the forecast period. It is projected to increase 3.1% this year, 4.1% next year, 3.3% in 2005, and 3.1% in 2006.

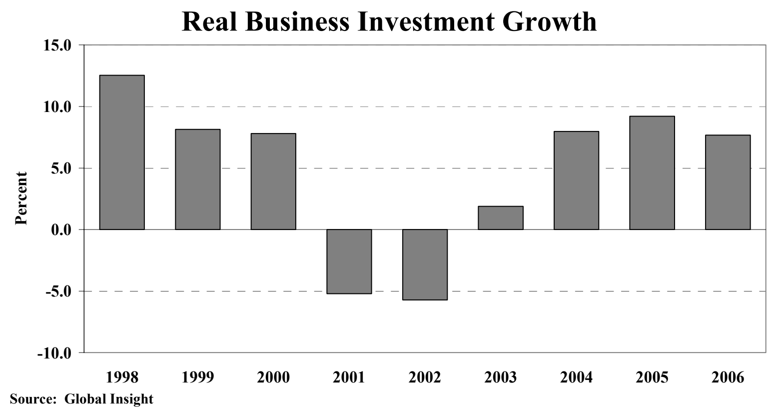
Inflation: Having weathered the recent deflation scare, attention is once again focused on inflation. The outlook calls for prices to rise modestly over the forecast period. Specifically, consumer price inflation is expected to remain below 2.5% through 2006. Inflation should be weakest next year, when it is projected to rise just 1.5%. The major reason for the benign inflation outlook is the struggling labor market. Employment costs account for a major portion of the price of final goods. Given the current and expected slack in labor markets, employees have curbed their compensation demands. Job security is more of a priority in labor negotiations. Under these conditions, employment costs are expected to decelerate over the next few years. After growing 3.8% in 2003, it is predicted to slow to 3.4% in 2004, 3.3% in 2005, and 3.1% in 2006. Employee benefit costs are expected to outpace wage and salary costs despite the former decelerating faster than the later. Benefit costs inflation should slow from a high of 6.1% this year to 4.0% in 2006. On the other hand, wage and salary inflation falls from 2.9% to 2.6% over this same period. It should be noted, however, while the general outlook is for low inflation, it is still vulnerable to temporary spikes caused by unforeseen events. One need not look far into the past to find examples. In fact, this year had its share of surprises. Uncertainties surrounding the War with Iraq caused consumers' energy prices to soar at a 42.9% annual rate in this year's first quarter. Late this summer consumers watched as the average price of gasoline quickly climbed to a record level. Factors contributing to this escalation include tight crude oil and gasoline supplies, temporary refinery shutdowns caused by the massive East Coast/Midwest blackout, a ruptured pipeline in Arizona, and strong gasoline demand. OPEC members agreed to cut production during their September 24, 2003 meeting in anticipation of Iraqi crude production recovering. This move was made to prevent a price decline caused by a surge in supply. It remains to be seen how this policy will play out. A major uncertainty is whether non-OPEC oil producers, such as Russia and Mexico, will voluntarily comply to restrict their production also.



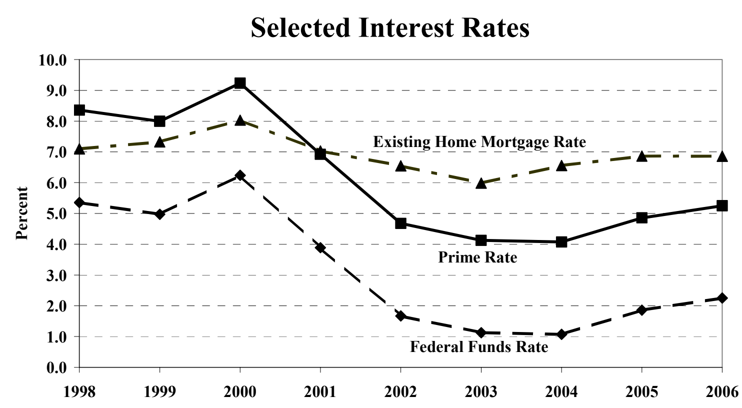
Housing: Housing sector concerns have increased recently as mortgage rates bottomed out and moved upwards this summer. These concerns are well placed, as the housing sector has been a strong performer that helped mitigate the impacts of the recession. A collapse of this sector would be felt throughout the economy. The housing sectors current rise has been steady. It began soon after the end of the 1990-91 recession. Home sales improved to 4.1 million units in 1992 from 3.8 million units the previous year. Housing starts jumped 20% from 1991 to 1992. During the rest of the decade the housing sector often out performed expectations. After years of growth, both housing sales and housing starts were well above their starting levels. Both stumbled in 2000, but these setbacks were minor. Housing sales declined just 0.5% and starts dropped 4.5%. Not only were these declines small, they were also short lived. Both sales and starts were growing again in 2001. Fueling this expansion were falling mortgage rates that reflected the Federal Reserve's aggressive loosening. With mortgage interest rates apparently hitting bottom this summer, it is no wonder the fate of the housing sector is in question. Interestingly, 2003 should be another strong year for both housing sales and starts. This is because of the heavy volume of sales and starts that took place before interests nudged upwards. In addition, the rising rates induced fence sitters to purchase homes before rates rose even further. As in the past, interest rates will play a huge role in this sector's outlook. Although rates are expected to move up, they will do so gradually. For example, the rate on a 30-year mortgage on an existing home is anticipated to grow just over one percentage point from 5.5% in 2003 to 6.8% in 2006. The slow rise in interest rates reflects the benign inflation over this period. Given the expected



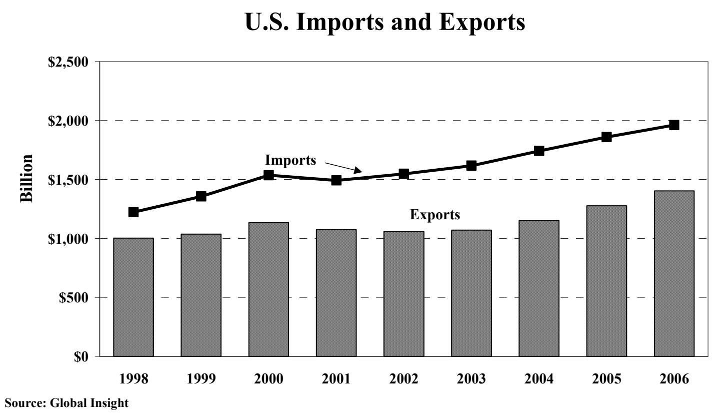
interest rate paths, the housing sector is expected to slow, but not collapse over the forecast period. Admittedly, home sales do drop over 9% and starts fall over 5% from this year to next, but these declines are from very high levels. After 2004, home sales are expected to remain in the vicinity of 6.1 to 6.2 million units per year. Housing starts should hover around 1.6 million units.



Business Investment: After stumbling in the first quarter, business investment on equipment and software seems to be taking the first real steps to a sustained recovery. While real investment is not expected to achieve the heady pace it enjoyed in the late 1990s and early 2000s, it should go from being a drag on the economy to once again propping it up. Fueled by Y2K worries, the Internet, and expanding telecommunications, business investment enjoyed its heyday a few years ago. Real spending on business equipment grew at least 11% annually from 1993 to 1999, and it peaked at nearly 15% in 1998. Real spending on software showed similar strength during this period, but peaked at over 25% in 1997. These two drivers helped total fixed investment grow much faster than real GDP through 2000. Recent experience has been different. Business investment fell victim to the high-tech implosion and actually declined in both 2001 and 2002. Ironically, the recovery in business investment results from some of the factors that made it collapse. Real spending on computers jumped a whopping 57% in the second quarter of 2003. Part of this increase was because of Y2K. Spending on computers surged in 1998-99 as systems were updated to avoid potential Y2K problems. These computers are now being replaced. In addition, businesses recognize that to remain competitive they need to invest in technology to raise productivity, for which computers have a proven track record. As such, real spending on computers and information equipment should grow strongly in the near term. Specifically, it should then advance more 20% (annual rate) in four of the next five quarters. This will transform investment from being a drag on the economy to an engine of growth. That is, after growing slower than real GDP from 2001 to 2003, real business investment should expand faster than real GDP from 2004 to 2006.



Financial: This forecast assumes the Federal Reserve will delay raising short-term rates until next summer. This should come as no surprise given current labor conditions and the near absence of inflation. In addition, the Federal Reserve traditionally resists changing its policy during presidential elections. If these were not enough reasons to believe changes will come later than sooner, one need only ask Federal Reserve members themselves. A couple of Federal Reserve members have made it clear recently they believe the economy remains soft. This would imply they are not anxious to begin tightening anytime soon. Interestingly, not everyone agreed. Financial markets were betting the Federal Reserve would begin tightening soon after the new year started. However, this line of thinking reached a dead end late last summer. The final blow came when the August 2003 employment report showed payroll employment declined 93,000. This had dashed hopes that employment was on the mend. As a result, financial markets are now anticipating the Federal Reserve will begin tightening next spring, which is still earlier than predicted by Global Insight. Financial markets have been wrong before trying to anticipate the timing of the central bank. This summer investors hoarded bonds in anticipation the Federal Reserve would be shopping for them in the future. When it became obvious this was not in the cards, these bonds were dumped in the market, quickly driving down their prices and driving up their yields. Since then, bond yields have stabilized. Home mortgage rates also began rising this summer after hitting their lowest levels in a generation. For example, from its nadir in the second quarter of 2003, the rate on a 30-year conventional mortgage jumped 60 basis points. Over the forecast period this rate is predicted to average 6.0% in 2003, 6.4% in 2004, 6.8% in both 2005 and 2006. The federal funds rate is assumed to be 1.1% this year, 1.1% next year, 1.9% in 2005, and 2.3% in 2006.



International: The U.S. is expected to lead the global economic recovery. The U.S. rebound will stimulate economic growth in the rest of the world, particularly non-Japan Asia and Oceania. These countries are well poised for a turnaround because local authorities have prepared the way with accommodative fiscal and monetary policies. In addition, the negative impacts of the SARS epidemic are quickly being reversed. Even the Eurozone and Japanese economies have shown signs of life recently. Unfortunately, their recoveries will be limited due to their leaders' reluctance to deal with structural economic problems and institutional constraints. Since these two regions account for a huge chunk of the world economy, their slow growth will be felt. It is predicted the world economy will not reach its trend growth rate of 3.0% until the second half of next year. And it will not peak until 2005, which is nearly four years after it bottomed out in 2001. However, this slow recovery may provide an extended life to the recovery. In this forecast the global economy is anticipated to grow an average of 3.3% from 2004 to 2008. It grew 2.5% yearly from 1998 to 2002. One of the concerns is the U.S. is taking on too much as the leader of the recovery and this is creating dangerous imbalances. For example, the U.S. current account balance has now reached 5% of GDP. Many economists feel that at this level investors may be reluctant to invest in U.S. assets. So far, this deficit has been financed by capital account inflows from Asia. Asia sells goods to the U.S., and Asian central banks purchase U.S. government securities. This arrangement appears to be working, but it remains to be seen whether it holds as the U.S. current account grows as a portion of GDP.

Employment: The National Bureau of Economic Research declared the 2001 recession ended in November 2001. However, employment is just beginning to show signs of revival. This has proven worrisome for economists who were hoping for an employment turnaround this summer. As late as August 2003, the U.S. Department of Labor reported nonfarm jobs were still being shed. A net job gain was reported for September 2003. It has been a long wait for an employment recovery. The U.S. began shedding nonfarm jobs in the second quarter of 2001. Since then, the number of jobs has declined in all but one quarter. The manufacturing sector has had it particularly bad. It began losing jobs in the third quarter of 2000. Since then, 2.7 million manufacturing jobs have been lost. The reason economic output continued growing despite falling employment is soaring productivity. Productivity increased at an astounding 6.8% rate in the second quarter of this year and is estimated to have risen about 5% in the third quarter. The good news is that productivity usually soars just before employers start adding to their payrolls. This is because employers hesitate to bring on additional employees until they are convinced the economy is improving. The bad news is the higher productivity has raised the expectations for employers. They will expect continued increased output from workers. This nonstop pressure to do more with less will continue to be a drag on employment. As a result, the employment situation is expected to improve slowly. The first sign of this is the long-awaited gain in employment has been delayed from this summer to the last quarter of this year. Next year promises to be the high-water mark for employment growth, with nonfarm jobs advancing over 2% per quarter. After 2004, nonfarm employment growth will slow to just below 2%. The manufacturing sector is not expected to post job gains until the second quarter of 2004, and it will grow about half as fast as total nonfarm employment. Due to the relatively soft employment picture, the U.S. unemployment rate is expected to improve gradually, from 6.1% in 2003 to 5.9% in 2006. As such, the economy is not expected to return to full employment over the forecast period.